Service Date: November 4, 1991

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER OF the Application	)	UTILITY DIVISION
of U S West Communications RE:	)	
Montana Network Improvement and	)	DOCKET NO. 90.12.86
Rate Stability Plan and Cost of	)	
Service/Rate Design.	)	ORDER NO. 5535c

ORDER IDENTIFYING ADDITIONAL ISSUES

Background

1. The Commission has identified several additional issues in Docket No. 90.12.86. The Commission finds that these issues should be addressed by U S West Communications (USWC), as well as by other interested parties by filing written testimony pursuant to the currently effective procedural schedule.

Additional Issues

Percentage Interstate Usage (PIU)

2. The response to PSC Audit Request No. 31 stated: “The U S WEST internal audit department has not performed any audits on reported intrastate minutes for other carriers.” During the 0CC hearing in Docket No. 88.11.49, it was noted that **intrastate access charges are higher than interstate access charges**. Given the fact that it is less costly to pay interstate access charges, it is vital that reported PIUs are accurate, Understated intrastate minutes could cause several problems, two of which are understated USWC carrier access revenues and encouragement of anti-competitive behavior in the intrastate toll market.

3. Parties should comment on how the issue of PIUs should be resolved in terms of

the revenue requirement effect in this case and all future cases. Also, how to ensure that PIUs are properly reported by each participant in the intrastate toll market. Should USWC conduct audits on all carriers prior to the hearing in this docket (as well as annual audits in future years) and reflect the increased carrier access revenues if any result? If it is determined that insufficient time exists to perform such audits prior to the hearing, should the Commission impute additional carrier access revenues? If this course of action is proposed by a party, the imputation should be based on supportable evidence.

4. Dr. Zahn, on behalf of AT&T, believes that each inter-exchange carrier's and reseller's PIU reports should be validated by an audit process and he proposed tariff language in this regard (response to PSC-254b). USWC must address both AT&T's concern and its proposed tariff language. The data reports forthcoming would also provide the Commission useful market share data.

Directory Revenues

5. USWC included a revenue requirement reduction of $3,983,000 to reflect excess profits associated with U S WEST Direct. MCC witness David Kirby makes two adjustments to the Company's proposed adjustment: (1) use of the 9.75% overall rate of return recommended by MCC witness Dr. Wilson; and, (2) imputation to directory investment the capital structure which includes 50% debt, which created a tax benefit for an interest deduction which was not reflected in the Company's tax calculation. Neither party's proposal permanently solves this controversial issue. The Commission asks all parties to put forward their proposals in testimony for a permanent solution to the issue of directory revenues. The basis for the solution should include a sharing of directory revenues between USWC and its ratepayers based upon a percentage split. This is an important difference from accepting a fixed dollar amount as is currently proposed due to the fact that these revenues grow each year.

Standards for New Service Offerings

6. It is often claimed by proponents of new regulatory regimes for telephone

companies that more freedom is needed to allow companies to become more efficient in the face of increasing competition. Historically, when new products are developed, they are first trialed in test markets, and then deployed in large urban areas, next in mid-size towns, and last in rural areas like Montana. This pattern has been repeated time and time again, with Montana being at the end of the cycle for new product and service introductions. It is important to note that for the last couple of years USWC has earned at or over its authorized rate of return. In spite of that, the pace of new products and services being introduced is extremely modest. There are a number of new and interesting products and services which will be developed in the near term. However, if history is any indication, those products will not be seen in Montana for some time to come. Parties are requested to testify on the desirability of establishing a standard which would require a certain number of new products and services to be introduced in Montana as a requirement for instituting a Rate Stability Plan. Parties' proposals should be specific regarding proposed standards and how to measure USWC's performance relative to those standards.

1+ Intralata Equal Access Capability

7. In a December 17, 1990, letter to Chairman Ellis, Mr. Ruff estimated a $7,500 cost per office to upgrade the Ericcson Switches for 1+ intralata equal access capability. In his letter, Mr. Ruff stated that the generic upgrade with this feature is scheduled for release during the 3rd quarter in 1992.

8. In passing the 1985 Montana Telecommunications Act, the legislature defined the purpose of the act as follows:

> The legislature declares that it remains the policy of the state of Montana to maintain universal availability of basic telecommunications service at affordable rates. To the extent that it is consistent with maintaining universal service, it is further the policy of this state to encourage competition in the telecommunications industry, thereby allowing access by the public to resulting rapid advances in telecommunications technology. It is the purpose of this part to provide a regulatory framework that will allow an orderly transition from a regulated telecommunications industry to a competitive market environment. (Sec. 69-3-802, MCA)

9. Given this clear statement of policy and purpose, the Commission would like

parties in this proceeding to comment on the desirability of including in USWC's proposed network modernization program the necessary investments to allow 1+ intralata equal access capability. Testimony on this issue should focus on the effect 1+ intralata equal access capability would have on universal service, and whether this would be a proper avenue to encourage competition.

10. Additionally, USWC must further identify the total costs to upgrade the network for 1+ intralata equal access capability. For instance, will all of the switches listed in Mr. Hayhurst's Sch. 2, Attachment A require the $7,500 upgrade or will an upgrade at each host provide 1+ intralata equal access capability at all connected remotes?

Impact of Montana's Decision Regarding the RSP

11. Many of the states in which USWC operates have approved or are considering approving some form of alternative regulation in order to encourage efficiency and innovation. Given the tendency of other states regulating USWC to adopt alternative regulation plans and given the small size of USWC's Montana operations in relation to the Company's entire operations, the Commission would like to know what impact Montana's decision on the proposed RSP could have on the Company's overall incentives to be innovative and operate efficiently.

12. If the majority of states in USWC's service territory opt for alternative regulation and this creates additional incentives for the Company to be efficient and innovative, won't those efficiencies and innovations automatically inure to USWC's Montana ratepayers without this Commission adopting alternative regulation?

13. Alternatively, what are the detriments to USWC's Montana ratepayers if the RSP or some other form of alternative regulation is not adopted by the Commission.

Telephone Service Quality

14. The Commission is charged with ensuring that regulated utilities provide customers with adequate service. If USWC's "Rate Stability Plan" is approved, there will be incentives for the company to cut costs through achieving operational efficiencies. Naturally, the Commission would not want service quality to deteriorate as a result of any cost-cutting efforts the company might undertake.

15. The Commission invites all parties in this proceeding to comment on whether the RSP should include incentives for USWC to maintain or improve existing service levels by requiring service quality objectives to be met before the company can share in excess earnings above whatever rate of return might be authorized. The Commission encourages parties to provide their specific ideas on this subject, including, for instance: what service objectives are the best indicators of company performance; how to measure and monitor service quality; and, how best to reward the company for improved service quality and penalize decreased service quality.

16. Following for the parties' information are summaries of alternative regulation plans proposed or approved by other states where phone companies' share of excess earnings depends in some manner on maintaining or improving service quality:

Alabama - The amount of excess earnings South Central Bell retains above the authorized return on equity is based on the company's performance in the areas of service quality and cost controls. Held orders and customer trouble reports are the indicators used to measure service quality.

Connecticut - Southern New England Telephone's approved incentive regulation plan provides that the company is allowed to share in excess earnings only if trouble reports do not exceed 2.5 reports per hundred access lines.

Georgia — Southern Bell is not allowed to share excess earnings if any exchange fails the trouble report standard of 5 reports per 100 access lines.

Louisiana — South Central Bell has proposed an incentive regulation plan in which sharing percentages would be determined in part by service quality measures.

New York — Rochester Telephone's approved regulatory incentive plan includes a provision for customer rebates if company's service quality slips.

Tennessee — Under the state's generic regulatory reform plan, participating large local exchange carriers' share of excess earnings is based on the company's level of service. Companies are required to report annually regarding: Commission complaints; installation appointments met; held orders; trouble reports; repair time; and overall customer satisfaction.

Utah - The Utah Division of Public Utilities recently proposed an incentive regulation plan for USWC in which the company's share of revenues under could be adjusted based on changes in service performance and service quality as reported annually. Service quality would be measured by the results of USWC's annual survey of Utah customers in which customers grade the company from A+ (excellent) to F (bad). Each year's composite survey percentage of A+/A grades would become the mid—point of a neutral range for the next year. The neutral range would be a range of 4% in which USWC and ratepayers would share earnings equally. If the composite percentage in any year exceeds the neutral range (2.1% above the mid-point), that year's shared earnings would be distributed 54% to USWC and 46% to ratepayers. Conversely, if the composite survey percentage of A+/A grades is below the neutral range, that year's shared earnings would be split 46% to USWC and 54% to ratepayers. In addition, a bonus or penalty would be assessed for the company's held order performance. USWC turned down the DPU's incentive regulation proposal.

Vermont — Under the Vermont Telecommunications Agreement which eliminated traditional rate of return regulation for New England Telephone, the company agreed, among other things, to maintain its quality of service in accordance with specific criteria.

Optimal Modernization Plans

17. During the hearing in Docket No. 90.12.86, the Commission will schedule one day for public testimony on what constitutes an optimal modernization plan for the state of Montana. Witnesses from all areas of society are invited to attend and provide their input. The Commission desires the broadest participation possible to ensure Montanans are provided with all of the telecommunications services they require.

18. One of the most serious concerns the Commission will raise involves the dearth of testimony and evidence on USWC's modernization plans and the relation of these plans to the balance of the AFOR Plan. USWC's plans would convert the existing system (switching and interoffice facilities) into a state-of-the-art digital system at roughly a $91 million price tag. The Commission firmly believes the record is inadequately developed in this regard. "State-of-the-art digital" and "$91 million dollars" are too simple of summary statements for the impacts the Plan will have on Montana ratepayers.

19. First, the Commission requests USWC to testify about its vision of the optimal telecommunications system for Montana by 2000, considering all forms of telecommunication available by that time. Second, the Commission requests USWC to describe the portion of such an optimally integrated telecommunications system that should be provided by traditional "telephone companies," including itself and any competitors. What are the forecast sales of new ("new" per HB 610-5-(3)) and existing products and services? Describe each and every new service offering USWC expects to provide. Third, the Commission requests USWC to testify about how it decided on the modernization it wishes to initiate, and on the level of investment. Since all regional Bell companies, including USWC, are already planning to replace much of their copper wire with fiber over the next two decades, why is no fiber, including fiber to the home, included in this Montana "modernization" program? How is the modernization strategy and level of effort driven by unmaterialized demands? How did USWC model risk and uncertainty? Finally, will the October 24, 1991, (5-0) decision of the Federal Communications Commission to allow local telephone companies to package and transmit television programming, change the presently proposed "modernization" strategy? What role does USWC see the Commission playing in this decision?

20. In addition to the above general questions, the Commission is interested in and requests USWC to testify on whether its modernization plans will overcome any pre-existing technological barriers to the innovation of certain new product applications. While the Commission will only focus on two applications, USWC should feel free to augment these items to address other applications. The first application involves whether the USWC modernized system will permit other Montana utilities to use the system for meter reading purposes. For example, would MPC be able to interconnect its gas and electric meters to the USWC modernized system for meter reading purposes? How does USWC's plan account for such applications whether they be gas, electric or water meters?

21. A second application involves whether the modernized system would allow a gas or electric utility to use USWC's system for load management purposes. By load management the Commission means load control via remote signaling. For example, would MPC in Butte, be able to remotely control the load of a customer, in Helena, by means of signaling over the USWC communications system?

22. Finally, as regards applications, the Commission is keenly interested in, and requests USWC to testify on, nontechnological barriers that would inhibit or prevent USWC from marketing the above general and two specific product applications.

Relevant Cost Studies and Cost Recovery Methods

23. Aside from the issue of what constitutes an optimally modernized system, there arises the question of who should pay for such a system. The continuum of cost recovery philosophies includes cost causer and social equity concerns, Each is discussed in turn.

24. Cost causer arguments to recover the costs of a modernized system involve cost-of-service studies. To generalize, such studies are typically embedded or some form of incremental cost study. Among the numerous costing proposals in this docket are USWC's long-run incremental cost (LRIC), and AT&T and MCI's interest in a building-block based LRICs.

25. To this partial list, MCC's witnesses raised numerous cost study approaches. Mr. Buckalew's testimony mentions a number of different cost—of-service studies between pages 32 and 39 of his September testimony which include: "annual cost analysis for service categories" (p. 32), "CAS" (p. 32), "embedded direct cost analysis on an annual basis" (p. 32), "marginal costs" (p. 33), "loop is a loop" (pp. 32-33) and "category cost analysis" (p. 34). While Dr. Wilson raised the concept of "total factor productivity" (at page 57), Mr. Buckalew actually asserts the Commission ought to think about the merit of a total factor productivity study in this docket (p. 38).

26. The Commission requests USWC to explain its understanding of the nature (embedded, incremental or other) and relation between these studies and recommend which of these it agrees can and should be provided on an annual basis per MCC's recommendation. The Commission also requests USWC to state its opinion on the relevant purpose (i.e., allocation of costs between regulated and deregulated services and pricing of any regulated service) of each cost study. As a point of clarity, the Commission is <u>not</u> ordering USWC to perform any of the cost studies listed by Mr. Buckalew; however, an ultimate Commission decision may impose such a requirement. Rather, the Commission believes USWC is the natural source of an explanation of the nature and relation of these various studies. Any other intervening party can, in turn, address the same Commission concerns. MCC may want to clarify its own testimony in this regard.

27. As noted above, the Commission also has interest in and requests USWC to testify on the social equity impacts of telephone modernization. In this regard, and aside from the above cost causer mechanisms of cost recovery, if telephone modernization is an economic development issue, why shouldn't society (through taxes) pay for the costs of a modernized telephone system? That is, why shouldn't the people who benefit from modernization pay the costs via taxing authorities and/or rate design?

Rate Stability in a Deflationary Environment Concerns

28. Dr. Wilson tied USWC's testimony to freeze prices to his apparent belief that the

industry environment is in either a declining cost (p. 52) or deflationary state (pp. 59, 61). With this premise, Dr. Wilson concludes that fixing rates for monopoly services, coupled with allowing flexible pricing for competitive services, will inhibit efficiency and productivity advancements. Dr. Wilson then recommends that all excess profit refunds (actually reduced rates) should be given only to fixed rate customers,

29. In light of Dr. Wilson's premise, conclusion and policy recommendation, the Commission requests USWC to address which services should be included in Dr. Wilson's "fixed rate customer" group, if adopted by the Commission. The Commission is particularly interested in how USWC views the relation of Dr. Wilson's fixed rate customer group to the category and list of basic (and related) exchange services in Mr. Hayhurst's Schedule C (December 1990).

Imputation or Inclusion of Relevant Costs

30. Imputation is the principle of including the prices for a monopoly service in the prices for a competitive service. The asserted purpose of imputation is to mitigate a price squeeze. Two parties (AT&T and MCI) raised a number of imputation or cost inclusion concerns in their direct testimony. First, Dr. Zahn's (AT&T) concerns include: 1) USWC excludes the incremental costs of its intraLATA toll service paid Independent Companies (p. 28-29); 2) access and billing charges paid ILECs must be included (p. 30); 3) USWC's price floors for non-basic services should reflect average incremental costs, adjusted for relevant imputations; 4) imputation should include public access line (PAL) service; and, 5) any non-basic service that uses an ONA offering as a component must be imputed (p. 46). Second, Mr. Ditirro (MCI) added that price squeeze concerns are not limited to toll and include special access, local area networks and payphones (pp.37-38).

31. Whereas the Commission is <u>not</u> requesting USWC to address the above issues, the Company may of course do so if it chooses. However, in data responses AT&T augmented its testimony to specify imputation tests and methods, and addressed procedural mechanisms to resolve its concerns. In this regard, the Commission requests USWC to address AT&T's data

responses numbered PSC-248-c, 250-c, -253-c, - 257-e and -258.

The Impact of Alternative Costing Methods on USWC's AFOR

32. As background, USWC proposed price floors based on long-run incremental costs (LRIC). Whereas AT&T and MCI support LRICs, they prefer an approach which is modified to reflect "building-blocks." MCI also discussed a five-step process to determine price floors involving a workshop process similar to Oregon's (pp.45-51). While silent on a building-blocks approach, Dr. Greer (MCC) believes LRICs should be used at such time as USWC's market share is sufficiently eroded.

33. Once more, the Commission leaves to USWC and other parties the option of addressing the above issues in their respective rebuttal testimony. Again, however, additional issues arose involving this topic but out of data responses. The Commission requests USWC to address the following issues raised in data responses. First, the Commission requests USWC to address both AT&T's proposal that USWC replace its current LRIC studies with a building-blocks approach at the conclusion of the Oregon workshop process (AT&T Data Response PSC-261) and, in contrast, MCI's proposal that the building-blocks approach be implemented prior to the Commission's approval of any incentive regulation (MCI Data Response PSC-262-c).

34. Second, the Commission inquired as to USWC's opinion on the merit of the Oregon workshop approach to develop LRICs (PSC065). USWC's response, in part, was that it would support any process that is geared toward a full discussion of the relevant methods and procedures that should be utilized when conducting a cost study, adding that any process that reduces the issues in a formal regulatory proceeding would be most welcome.

35. While the Oregon workshop approach and cost methods are by no means a fait accompli in the present docket, the Commission requests USWC to expand on its response. To avoid numerous "what if" scenarios, the Commission would note its general interest in how USWC believes a workshop approach, to resolve costing issues, would integrate with other

aspects of USWC's Plan in Docket No. 90.12.86. Specifically, the Commission is interested in USWC's response to MCI's above-referenced proposal (MCI Data Response PSC262—c).

Product proliferation and Anticompetitive Strategic Behavior

36. As background, MCC's Dr. Greer proposed a phased deregulation process whereby the competitive hypothesis can be tested. During the first two phases, Dr. Greer testified for the need to curb anticompetitive strategic behavior of the dominant firm, adding that product proliferation is the most popular of several anticompetitive strategies. Also as background, the Montana Legislature added the new services section to the MTA in 1991 (HB 610 Section 5 (3)). The new service section permits USWC to file prices for alleged new services on a detariffed basis. The statute sets three general conditions an alleged new service must meet in order for the Commission to find that, in fact, the service is new.

37. First, the Commission requests USWC to address Dr. Greer's anticompetitive strategic behavior concern in the context of USWC's ability to proliferate products under the guise of new services, when in fact the products are not new. Second, the Commission requests USWC to interpret the three general conditions that an alleged new service must meet to indeed qualify as a new service. USWC's interpretations should provide the Commission adequate guidance so that any future service filing can be determined to, indeed, be new.

Extended Area Service

38. The Commission has recently received several extended area service inquiries. For example, several recent inquiries involved the communities of Shepherd, Clyde Park, Boulder/Basin, and Brady-Conrad. The Commission requests USWC's testimony on the continued merit of EAS vis-a-vis alternative means of providing service. Some alternatives would include expanded local calling areas as well as MTS.

Outstanding Issues From Docket No. 88.1.2

39. In Order No. 5354a, the Commission granted USWC's proposed Late Payment Charge (LPC), as stipulated between USWC and MCC. The Commission approved a LPC of 1% applicable to all billed balances greater than $25.00 which are not paid by the billing date shown on the next bill. The Commission also approved several exceptions to the application of the LPC. The Commission directed USWC to provide sufficient data in its next rate case to compute a LPC which would apply to the portions of a bill exceeding $35.00. The Commission also directed USWC to address several other concerns listed in Finding of Fact (FOF) No. 298 which includes a citation to other issues listed in FOF Nos. 33-36 in Order No. 5354a and FOF 16 in Order No. 5354c. The Commission directs USWC to file testimony addressing these issues.

40. The Commission is also concerned with information provided on a customer's bill and the way in which such information is presented. Specifically, the Commission is concerned that customers are fully aware of the actions USWC would take if a customer failed to make payments for deregulated as opposed to regulated services. The Commission is also concerned that customers would be made fully aware of phone numbers through which customers can reach USWC's service representatives for questions regarding their bills. The Commission directs USWC to address this issue in testimony. The Commission invites other parties to submit testimony regarding the above issues.

Dockets Consolidated with Docket No. 90.12.86

41. The procedural order in this case lists the following dockets as those consolidated with 90.12.86:

1. 89.8.28, re: Dual Service
2. 89.8.35, re: Integrated Services Digital Network
3. 89.9.29, re: Open Network Architecture
4. 90.5.32, re: Digital Switched Service

Of these dockets, the Commission directs USWC to file testimony addressing the below listed issues for items 2 and 3. The Commission's rationale for requesting testimony on these dockets and the issues involved follow.

42. **Docket No. 89.8.35, ISDN**. ISDN provides a means for a customer to integrate voice and data transmissions over a single copper wire pair. The Commission granted interim approval of USWC's ISDN tariff which features unbundled access facilities and case-by-case pricing for ISDN features. USWC's tariff states that it would file any contract for ISDN for Commission approval. Order No. 5468 notes that USWC stated that case-by-case pricing was required since costs would vary by customer. USWC did not include any costs in its initial filing.

43. Through discovery in Docket No. 90.12.86, USWC provided a cost study for one of its ISDN customers (USWC RDR PSC-ll8 (proprietary)). The information provided appears cryptic regarding the services each price and cost represents. The Commission directs USWC to file testimony supporting the cost approach USWC would use for ISDN services it would typically provide in Montana. Included in this testimony, USWC is required to support the cost and pricing methods it would use if it were to provide ISDN service to an hypothetical Montana customer. Other related topics follow.

44. First, FOF 5 in Order No. 5468 states that "USWC argues that introducing ISDN to large customers at this time will allow ISDN to reach its full potential and ensure the ISDN will be available to smaller customers in the future." The Commission directs USWC to explain what the full potential for ISDN is, how smaller customers would benefit from ISDN, and the level of large customer ISDN subscription that would be necessary before it would be cost-effective for USWC to provide ISDN to its smaller customers. Second, the Commission directs USWC to address the assurances the Commission would have that ISDN services would not be subsidized by other services. USWC does not appear to have filed testimony regarding these issues in this docket.

45. The Commission is also concerned with the relationship ISDN would play with the role of service provisions in the future. The legislature declared the policy behind of the Montana Telecommunications Act (MTA) , in part, was to "...maintain universal availability of basic telecommunications service at affordable rates" while encouraging competition in the telecommunications industry. (Sec. 69—3-802, MCA) The Commission is concerned with how

the definition of universal service may change in the future. More specifically, how does USWC foresee the definition of basic service which would fall under the umbrella of universally provided service encompass ISDN and/or other services? Additionally, how does USWC foresee the evolution of plain-old telephone service (POTS) with its modernization program? Would POTS, which may now be defined as single or multi-party rotary service, evolve into purely single—party touchtone service? The Commission, therefore, directs USWC and invites other parties to file testimony addressing how the definition of basic, universally provided service may change in the future. USWC is encouraged to address this issue over a time frame that exceeds the limits of its proposed five-year AFOR plan.

46. **Docket No. 89.9.29, ONA**. In Docket No. 89.9.29 the Commission granted interim approval of six custom calling features USWC identified as Open Network Architecture (ONA) services since USWC did not have an acceptable costs in place (see Order No. 5467, FOF 8). USWC maintained that ONA services should not subsidize local exchange service nor should the cost of local exchange services be impacted by ONA services (Id, FOF 5). The Commission directs USWC to substantiate these claims with empirical evidence and a review of its ONA pricing methods. This would include a examination of ONA type services which USWC may consider as Non-ONA depending on the customer classes to which these services are provided. The Commission directs USWC to outline and justify its marketing and pricing strategies for ONA services, including a projection of the dates upon which it intends to make its various ONA services available in each of its exchanges. Additionally, the Commission directs USWC to justify its application of market-based pricing for ONA services. Although USWC filed testimony regarding basic and non-basic services, it does not appear to have filed testimony addressing ONA as a separate issue.

47. A related issue regards the distinction USWC would make between a service it would provide as an ONA and as a non-ONA. This issue regards the way in which USWC may label, described or market a service which may provide different utility to different customers but would be functionally the same for all customers. For instance, consider a possible comparison if a service were provided to an enhanced service provider (ESP) and was considered

non-basic, yet the same service was provided as a basic exchange service. Should the service provided to the ESP be subject to the same regulatory status as the service provided as a local exchange service? Also, would value of service, repackaging, and/or functional equivalency standards allow USWC to detariff a service provided to one customer class (ESPs, for instance) yet allow the same service to be labeled, described, or packaged differently, to be tarif fed for another class? The Commission directs USWC and invites other parties to address the above issues in testimony.

Previous Forbearance Filings

48. In response to DR PSC-8, 120, and 196, USWC provided certain information regarding the customers USWC serves under forbearance contracts. One of these responses includes some proprietary information USWC uses to set forbearance contract prices for toll services. The information provided does not, however, appear to include analysis showing that any of USWC's currently contracted forbearance prices cover costs. Recent Commission orders approving forbearance filings specifically state the Commission would examine the cost/price relationship for negotiated forbearance contract prices (see, e.g., FOF 5, Order No. 5481). The Commission directs USWC to show that the prices for the services in its forbearance contracts cover all relevant costs.

Further, USWC must define what it considers to be the relevant costs for services rendered through these contracts.

Cost of Service (COS) Issues

49. In this case USWC filed several COS studies. These studies can be categorized as usage and non-usage and recurring and non-recurring related studies. USWC computed usage costs for services such as MTS, WATS, and Switched Access using its Regional Integrated Network Cost Analysis Program (RINCAP) (Rach-Santos De La Rosa, Direct, pp. 7-8). USWC computed costs for services with usage beyond a normal telephone call were performed for

services such as Custom Calling and TeleChoice using its Switching Cost Model (SCM) (Id.*)*. The Commission has several concerns regarding the methods and data USWC employed to compute costs using its RINCAP and SCM models. USWC is directed to file testimony addressing these concerns as stated below and in Proprietary Appendix A of this order.

50. First, Dr. Bowman states that USWC uses the capacity cost concept (CCC) in its cost models (Bowman direct, pp. 18-19). Dr. Emmerson states that this method proxies long—run incremental costs for "lumpy investments and shared resources" provided that several assumptions are met as listed in his direct testimony, p. 26. Further, Dr. Emmerson lists two conditions which must be met in order for capacity costing approach to be useful. Dr. Emmerson maintains that "…. forecast demand ... must outgrow the existing capacity prior to planned replacement for technological or other non-use related reasons" and ". . .changes in demand must be of sufficient duration to affect future component placements." (Emmerson, Direct, p. 27) . Based on these assumptions, the Commission is concerned as to whether USWC's application of the CCC is appropriate for computing costs for services offered in Montana. Specifically, would USWC's cost methods produce results reflective of potential changes in market conditions such as market share for competitive services? Also, would USWC's application of the CCC in its cost computations for services offered in or between exchanges where switching or interoffice transport capacities may never be exhausted or in exchanges which experience zero or negative growth in service demands be economically correct? The Commission directs USWC, and invites other parties, to address these concerns.

51. The Commission is also concerned with the specific methods USWC uses to compute costs using its base-case/change-case simulation method in RINCAP as described by Ms. Rach-Santos De La Rosa at pages 11 through 12 and in the work papers supporting the studies performed using RINCAP (see USWC RDR PSC-5). The Commission is also concerned with some of USWC's data sources it uses to compute its costs in its SCM. Due to the proprietary nature of these issues, the Commission's concerns are discussed in Proprietary Appendix A of this order.

Capped Price vs. Fixed Price

52. In its rate proposals, USWC classified telecommunications services as either basic and non-basic. Some of USWC's non-basic services would have fixed prices (for example, Telechoice service) and some would have capped prices (MTS). USWC states that price caps are incentive regulation schemes which allow customers to share benefits and make USWC to be more competitive in today's telecommunication market.

53. At the scheduled work session on October 30, 1991, the Commission directed USWC to address why some of its non-basic services are price-fixed and some are price-capped. The Commission would like to know the standards USWC used to distinguish its non-basic services so that some have capped prices and others have fixed prices.

Cost-based vs. Valued-based Pricing

54. USWC's non-basic services can be further classified as competitive and non-competitive services. The Commission finds that USWC has different pricing policies for these services. For competitive services, USWC usually proposes prices to fluctuate in response to the competitive market forces (Pierce's Testimony, pp. 5-6) . For other services, which are usually considered non-competitive services (for example, Telephone Listing Service and TeleMarque Service), USWC usually proposes to set prices based on value of service (Pierce's Testimony, page 7).

55. The Commission believes that if a non-competitive service is priced at its perceived value, the price will reflect how much a customer is willing to pay. Since USWC has monopoly power in its non-competitive service market, in theory, it can set the price at the monopoly price and gain monopoly profit. Based on this background, the Commission requests USWC to further address the issue of its general pricing policy. Specifically, the Commission is interested in testimony on how USWC justifies its value-of-service pricing given monopoly power concerns.

DONE AND DATED this 4th day of November, 1991, by a 5 to 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

HOWARD L. ELLIS, Chairman

DANNY OBERG, Vice-Chairman

WALLACE W. "WALLY" MERCER, Commissioner

JOHN B. DRISCOLL, Commissioner

BOB ANDERSON, Commissioner

Ann Peck
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.

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